

MERCED COUNTY

Audit Report

APPORTIONMENT AND ALLOCATION OF PROPERTY TAX REVENUES

July 1, 2017, through June 30, 2021



MALIA M. COHEN
California State Controller

January 2023



MALIA M. COHEN
California State Controller

January 12, 2023

The Honorable Lisa Cardella-Presto, Auditor-Controller
Merced County
2222 M Street
Merced, CA 95340

Dear Ms. Cardella-Presto:

The State Controller's Office audited Merced County's process for apportioning and allocating property tax revenues for the period of July 1, 2017, through June 30, 2021. We conducted the audit pursuant to the requirements of Government Code section 12468.

Our audit found that the county incorrectly calculated the tax rate area factors for the Redevelopment Property Tax Trust Fund.

If you have any questions, please contact Lisa Kurokawa, Chief, Compliance Audits Bureau, by telephone at (916) 327-3138.

Sincerely,

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

KT/ac

cc: Janey Cabral, Assistant Auditor-Controller
Merced County
Sylvia Sanchez, Property Tax Manager
Merced County Auditor-Controller's Office
The Honorable Lloyd Pareira, Jr., Chairman
Merced County Board of Supervisors
Chris Hill, Principal Program Budget Analyst
Local Government Unit
California Department of Finance

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Audit Report

Summary

The State Controller's Office (SCO) audited Merced County's process for apportioning and allocating property tax revenues for the period of July 1, 2017, through June 30, 2021.

Our audit found that the county incorrectly calculated the tax rate area (TRA) factors for the Redevelopment Property Tax Trust Fund (RPTTF).

Background

After the passage of Proposition 13 in 1978, the California State Legislature (Legislature) enacted new methods for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts. The main objective was to provide these agencies and districts with a property tax base that would grow as assessed property values increased. The method has been further refined in subsequent laws passed by the Legislature.

One key law was Assembly Bill 8, Chapter 282, Statutes of 1979, which established the method of allocating property taxes for fiscal year (FY) 1979-80 and subsequent fiscal years. The methodology is commonly referred to as the "AB 8 process."

Property tax revenues are apportioned and allocated to local government agencies, school districts, and community college districts using prescribed formulas and methods defined in the Revenue and Taxation Code. In general, the amount that an agency or district receives each fiscal year is based on the amount received in the prior year plus a share of the property tax growth within its boundaries.

The AB 8 process involves several steps, including the transfer of revenues from school and community college districts to local government agencies and the development of the TRA annual tax increment (ATI) apportionment factors, which determine the amount of property tax revenues to be allocated to each jurisdiction.

The total amount to be allocated to each jurisdiction is then divided by the total amount to be allocated to all entities to determine the AB 8 factor for each entity for the year. The AB 8 factors are computed each year for all entities using the revenue amounts established in the prior year. These amounts are adjusted for growth annually using ATI apportionment factors.

Subsequent legislation removed from the AB 8 process revenues generated by unitary and operating nonunitary properties, pipelines, regulated railway companies, and qualified electric properties. These revenues are now apportioned and allocated under separate processes.

Other legislation established an Educational Revenue Augmentation Fund (ERAF) in each county. Most local government agencies are required to transfer a portion of their property tax revenues to the fund. The fund is subsequently apportioned and allocated to school and

community college districts by the county auditor according to instructions received from the county superintendent of schools or the chancellor of the California community colleges.

Taxable property includes land, improvements, and other properties that are accounted for on the property tax rolls, which are primarily maintained by the county assessor. Tax rolls contain an entry for each parcel of land, including parcel number, owner's name, and value. The types of property tax rolls are:

- *Secured Roll*—Property that, in the opinion of the assessor, has sufficient value to guarantee payment of the tax levies and that, if the taxes are unpaid, the obligation can be satisfied by the sale of the property by the tax collector.
- *Unsecured Roll*—Property that, in the opinion of the assessor, does not have sufficient permanence or other intrinsic qualities to guarantee payment of taxes levied against it.
- *State-Assessed Roll*—Utility properties composed of unitary and operating nonunitary value assessed by the California State Board of Equalization.
- *Supplemental Roll*—Property that has been reassessed due to a change in ownership or the completion of new construction, where the resulting change in assessed value is not reflected in other tax rolls.

To mitigate problems associated with the apportionment and allocation of property tax revenues, Senate Bill 418, which requires the SCO to audit the counties' apportionment and allocation methods and report the results to the Legislature, was enacted in 1985.

Apportionment and allocation of property tax revenues can result in revenues to an agency or agencies being overstated, understated, or misstated. Misstated revenues occur when at least one taxing agency receives more revenue than it was entitled to, while at least one taxing agency receives less revenue than it was entitled to.

The agency that received less tax revenue than its statutory entitlement would have standing to require that adjustments be made by the county, either on a retroactive or prospective basis. The SCO does not have enforcement authority or standing to require the county to take corrective action with respect to misallocation of tax revenues, unless the misallocation resulted in overpaid state funds (e.g., funds intended for the ERAF, school districts, or community college districts). The SCO has authority to recover misallocations resulting in overpaid state funds pursuant to Government Code (GC) sections 12410, 12418, and 12419.5.

GC section 12410 provides the SCO with broad authority to "superintend the fiscal concerns of the state." GC section 12418 provides the SCO with the authority to "direct and superintend the collection of all money due the State, and institute suits in its name" against all debtors of the State. GC section 12419.5 provides the SCO with the authority to offset any amounts due the State against any amounts owed to the debtor by the State.

Revenue and Taxation Code (RTC) section 96.1(b) allows a reallocation of current audit findings and unresolved prior audit findings.

RTC section 96.1(c)(3) limits a cumulative reallocation or adjustment to one percent of the total amount levied at a one-percent rate of the current year's original secured tax roll. For reallocation to the ERAF, school districts, or community college districts, a reallocation must be completed in equal increments within the following three fiscal years, or as negotiated with the SCO.

Audit Authority

We conducted this audit under the authority of GC section 12468, which requires the SCO to audit the apportionment and allocation of property tax revenues on a one-, three-, or five-year cycle, depending on the city and county's population. The audit results are reported annually to the Legislature along with any recommendations for corrective action.

Objective, Scope, and Methodology

Our audit objective was to determine whether the county complied with Revenue and Taxation Code, Health and Safety Code, and Government Code requirements pertaining to the apportionment and allocation of property tax revenues.

A property tax bill contains the property tax levied at a one percent tax rate pursuant to the requirement of Proposition 13. A tax bill may also contain special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city. The scope of our audit is concerned with the distribution of the one percent tax levy. Special taxes, debt service levies on voter-approved debt, fees, and assessments levied by the county or a city are beyond the scope of our audit and were not reviewed or audited.

The audit period was July 1, 2017 through June 30, 2021.

To achieve our objective, we performed the following procedures:

- We gained an understanding of the county's process for apportioning and allocating property tax revenues by interviewing key personnel.
- We reviewed the county's written procedures for apportioning and allocating property tax revenues.
- We reviewed documents supporting the transaction flow for apportioning and allocating property tax revenues.
- We judgmentally selected a non-statistical sample of five from approximately 44 taxing jurisdictions within the county for all fiscal years in the audit period.¹ Then, we:
 - Recomputed apportionment and allocation reports to verify computations used to develop property tax apportionment factors;

¹ The actual number of taxing jurisdictions can vary from year to year based on jurisdictional changes. For testing purposes, we included the ERAF in our sample of taxing jurisdictions. We also tested a special district, a school district, a city, and the county. We selected only one of each type of local agency because when the apportionment and allocation for one jurisdiction is incorrect, the error affects every other taxing jurisdiction.

- Tested TRA reports to verify that the correct TRA factors were used in the computation of the ATI;
- Reviewed supplemental property tax administrative costs and fees to determine whether recovery costs associated with administering supplemental taxes were based on actual costs and did not exceed five percent of revenues collected, as prescribed in statute;
- Verified computations used to develop supplemental property tax apportionment factors;
- Verified unitary and operating nonunitary, and unitary regulated railway computations used to develop apportionment factors;
- Reviewed redevelopment agency reports and verified computations used to develop the project base amount and the tax increment distributed to the redevelopment agency;
- Reviewed RPTTF deposits (see the Finding);
- Reviewed property tax administration cost reports and recomputed administrative costs associated with work performed for apportioning and allocating property tax revenues to local government agencies, school districts, and community college districts;
- Reviewed ERAF reports and verified computations used to determine the shift of property taxes from local government agencies to the ERAF and, subsequently, to school and community college districts;
- Reviewed and verified Vehicle License Fee computations used to determine the amount transferred from the ERAF to counties and cities to compensate for the diversion of these revenues; and
- Reviewed California State Board of Equalization jurisdictional change filing logs and their impact on the tax apportionment and allocation system.

Errors found were not projected to the intended (total) population.

We did not audit the county's financial statements.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

Our audit found that Merced County did not comply with California statutes for the apportionment and allocation of property tax revenues for the audit period. Specifically, we determined that the county incorrectly calculated the TRA factors for the RPTTF.

This instance of noncompliance is described in the Finding and Recommendation section.

**Follow-up on Prior
Audit Findings**

The county has satisfactorily resolved the findings noted in our prior audit report, for the period of July 1, 2014, to June 30, 2017, issued on January 16, 2019.

**Views of
Responsible
Officials**

We issued a draft report on November 29, 2022. Lisa Cardella-Presto, Auditor-Controller, responded by letter dated December 5, 2022, agreeing with the audit results. The county's response is included as an attachment to this audit report.

Restricted Use

This audit report is solely for the information and use of Merced County, the Legislature, the California Department of Finance, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of this audit report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

KIMBERLY TARVIN, CPA
Chief, Division of Audits

January 12, 2023

Finding and Recommendation

FINDING— Redevelopment Property Tax Trust Fund and Recognized Obligation Payment Schedules

During testing of the county’s RPTTF calculations, we found that the county incorrectly altered the TRA factors of several former redevelopment agency TRAs starting in FY 2020-21. We could not quantify the monetary effect on each taxing jurisdiction due to the cumulative effect of the errors affecting the computation.

The error occurred because the county changed redevelopment agency TRAs in an effort to comply with a January 11, 2013 letter from the California Department of Finance. The letter states that the ERAF is statutorily entitled to receive residual property tax revenues from the RPTTF process. The county included the ERAF’s TRA factors when calculating RPTTF distributions. As a result, school TRA factors increased, while city and special district TRA factors decreased.

The incorrect TRA factors caused school entities to overpay to the RPTTF, and cities and special districts to underpay to the RPTTF. This occurred for several former redevelopment agency TRAs.

RTC section 97.401 and Health and Safety Code sections 34182 through 34188 provide the legal requirements for administration of the RPTTF.

In 2012, the Legislature passed a law dissolving the previously established redevelopment agencies. Provisions of the law included the creation of successor agencies and oversight boards to oversee the winding-down of the defunct agencies’ affairs.

Under the applicable Health and Safety Code sections, successor agencies will receive the ATI previously given to redevelopment agencies to fund payments of their obligations, including but not limited to administrative costs, pass-through payments, and debts.

Recommendation

We recommend that the county:

- Review RTC section 97.401 and update its procedures to ensure that no former redevelopment agency TRA factors are changed;
- Correct all former redevelopment agency TRA factors that were incorrectly adjusted;
- Recalculate former redevelopment agency ATIs beginning with FY 2020-21; and
- Make monetary adjustments to the affected taxing entities.

County’s Response

The County of Merced agrees with this audit finding. The calculations for the TRA factors and ATIs have been completed. Monetary adjustments will be made going forward.

Appendix— Summary of Prior Audit Findings

The following table shows the implementation status of Merced County's corrective actions related to the findings contained in our prior audit report, dated January 16, 2019:

Prior Audit Finding Number	Prior Audit Finding Title	Status
1	Supplemental Property Tax Apportionment and Allocation	Fully implemented
2	Supplemental Property Tax Administrative Costs	Fully implemented
3	Redevelopment Property Tax Trust Fund and Recognized Obligation Payment Schedules	Fully implemented

**Attachment—
County's Response to Draft Audit Report**



Lisa Cardella-Presto, CPA
Auditor-Controller

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Equal Opportunity Employer

To: Lisa Kurokawa, Chief
Compliance Audit Bureau
State Controller's Office

December 5, 2022

In an audit conducted by the State Controller's Office for the period of July 1, 2017 to June 30, 2021, there was a finding that the County incorrectly altered the TRA factors starting in FY 2020-21.

The County of Merced agrees with this audit finding. The calculations for the TRA factors and ATI's have been completed. Monetary adjustments will be made going forward.

If you have any questions, please contact Sylvia Sanchez, Property Tax Manager, at (209) 385-7511.

Sincerely,

A handwritten signature in blue ink that reads "Juney Cabral". The signature is fluid and cursive.

Juney Cabral
Assistant Auditor-Controller

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